

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

EDGEWOOD RESORT, INC.

CASE NO. 93-62150

Debtor

Chapter 11

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

The Court has before it the motion of Virginia A. Hoveman, Esq., ("Trustee"), the Trustee whose appointment in this Chapter 11 case pursuant to §1104 of the Bankruptcy Code (11 U.S.C. §§101-1330) ("Code") was approved by Order of this Court dated May 17, 1995. The Trustee's motion seeks to obtain this Court's approval of her employment of American Hotel Management Associates, Inc. ("AHMA") to operate the Debtor's hotel facility located at Alexandria Bay, New York.

The contested matter was initially brought before the Court by way of an Order to Show Cause which was orally argued in Syracuse, New York on June 20, 1995. Following oral argument, the matter was scheduled for an evidentiary hearing at Utica, New York on July 13, 1995. Upon completion of the evidentiary hearing, the parties were given two weeks in which to file memoranda of law.

The Trustee's motion is opposed by Judith Wade ("Wade") and Jeffrey Hebert ("Hebert"), the sole stockholders and former managers of the Debtor.

At the conclusion of the July 13, 1995 evidentiary hearing, the Court orally ruled that the Trustee had met her burden of proof with regard to the need for the employment of a hotel management team, but reserved on the designation of AHMA as that manager.¹

JURISDICTIONAL STATEMENT

The Court has core jurisdiction of this contested matter pursuant to 28 U.S.C. §§1334(b), 157(a), (b)(1), (b)(2)(A) and (O).

FACTS

Debtor is the owner and operator of a hotel facility located on the St. Lawrence River in the resort community of

¹ By Order dated May 26, 1995, this Court appointed AHMA on an interim basis to evaluate and monitor the Debtor's operations. That Order additionally authorized the Trustee to employ Wade and Hebert at her discretion. That Order, with some modification, has been continued to date.

Alexandria Bay, located in northern New York State. Debtor filed a voluntary petition pursuant to Chapter 11 of the Code on July 12, 1993. Debtor is without a confirmed plan of reorganization or liquidation. In the fall of 1994, this Court denied confirmation of the Debtor's most recent Chapter 11 plan and upon motion of the Federal Deposit Insurance Corporation ("FDIC") authorized the appointment of a Trustee by Order dated May 1, 1995. The appointment of the Trustee was grounded upon Code §1104(a)(2).

Prior to the commencement of the Chapter 11 case, the Debtor's hotel facility had been managed primarily by Wade and Hebert, who are siblings, and whose family had operated the Debtor for a number of years. Upon entering her duties, the Trustee almost immediately experienced management problems arising primarily from bickering and disputes between Wade and Hebert, who exercised separate management functions, but who frequently criticized each others management, resulting in divided loyalties of employee factions at the hotel. The Trustee's immediate concerns centered on the management and security of Debtor's cash flow. It was these difficulties and concerns that prompted the Trustee to seek the assistance of AHMA on an interim basis prior to the 1995 Memorial Day weekend, traditionally the beginning of the Debtor's lucrative summer season.

Pursuant to the May 26, 1995 Order, the Trustee continued to employ Hebert and Wade to perform their current employment functions, with AHMA acting as a monitor and evaluator of the Debtor's current management. By June 12, 1995, the Trustee, in consultation with AHMA, concluded that the Debtor's hotel was not

being operated in accordance with standard hotel practices and sought the employment of AHMA on a long term basis to operate the hotel, excluding Wade and Hebert from management functions.

In the interim, the Trustee had also contacted a competing hotel management company, Lodging Unlimited, Inc. ("Lodgings"), but had concluded that their fees would significantly exceed those of AHMA for essentially the same type of management services.

The Trustee acknowledged that AHMA was recommended to her by both the FDIC and Debtor's counsel and that she is aware that AHMA currently manages a Holiday Inn facility, on behalf of the FDIC, in Ogdensburg, New York, also located on the St. Lawrence River approximately 40 miles to the northeast of Debtor's facility. The Trustee denied that the FDIC had conditioned her continued use of their cash collateral on her selection of AHMA as Debtor's manager.

AHMA has been engaged in the business of managing hotels since 1974 and has previously operated hotels that had filed petitions in bankruptcy. It has also acted as a receiver of other hotel properties for the FDIC and, in fact, had been considered by the FDIC to take control of the Debtor's hotel prior to the filing of this Chapter 11 case.

AHMA's president, John Connelly, testified that he considers the Holiday Inn facility in Ogdensburg, which his company also manages, as a "transient" hotel and consequently not a competitor of Debtor's facility, which he characterized as a long term "resort" hotel. In support of his conclusion, he testified

that the current room rate at the Holiday Inn was \$52 per night while at the Debtor's facility it was \$102 per night. Conversely, Daniel O'Brien, a travel and tourism consultant, testified that the Debtor and the Holiday Inn in Ogdensburg are pursuing the same segment of the travel and tourism market in the area of New York State known as the "Thousand Islands Region". He did acknowledge that Alexandria Bay is, however, more in the nature of a resort community than Ogdensburg and that he had made no actual operational analysis of either facility.

ARGUMENTS

The Trustee initially asserts that both Wade and Hebert have a "standing" problem in objecting to AHMA's employment since they are not creditors of Debtor's estate within the meaning of Code §327(c). The Trustee, however, tempers this argument by opining that Code §327 is not even implicated here because AHMA does not fall within the definition of a "professional person" and, therefore, subject to appointment pursuant to Code §327(a).

On the issue of conflict of interest being raised by Wade and Hebert, the Trustee asks the Court to totally discount the testimony of O'Brien who she contends displayed no specific knowledge of either facility other than to reach the obvious conclusion that both are located in the same geographical region of New York State.

Since the hearing of July 13, 1995, the Trustee has advised the Court, in affidavit form, that on the morning of July

15, 1995, the Debtor's hotel facility experienced high winds and/or a tornado, resulting in significant damage and disruption of services to guests. The Trustee asserts that she was ably assisted by AHMA personnel, both from its home office and the Ogdensburg facility, in coping with this emergency and that in the aftermath of that storm, a change in hotel management at this juncture would be devastating.

Wade and Hebert contend that AHMA has an inherent conflict of interest in representing the FDIC, a creditor of the Debtor, via its operation of the Ogdensburg Holiday Inn and the Trustee herein. Wade and Hebert point to the ongoing relationship between the FDIC and AHMA, particularly in regard to Debtor's Chapter 11 case.

Finally, Wade and Hebert ask the Court to consider the fact that at the time of the May 26th Order appointing AHMA on an ex parte interim basis, it did not disclose its relationship with the FDIC and, in fact, did not acknowledge that relationship until challenged by these objectants.

DISCUSSION

As the Court has indicated, after hearing the testimony on July 13, 1995, and reviewing the Trustee's moving papers, as well as the opposition of Wade and Hebert, it concluded that the Trustee should not be required to continue the Debtor's business utilizing Wade and Hebert as co-managers of the hotel facility. The only issues left to the parties for briefing was the alleged

conflict of interest of AHMA by virtue of its representation of the FDIC both in this case and in connection with the operation of the Ogdensburg Holiday Inn, as well as its alleged failure to disclose that potential conflict of interest prior to the Court's execution of its May 26, 1995 Order.

At the outset, the Trustee makes a somewhat half-hearted argument that AHMA should not be considered a professional requiring appointment within the meaning of Code §327². Trustee relies on the rationale of In re Century Inv. Fund VII Ltd. Partnership, 96 B.R. 884 (Bankr. E.D.Wis. 1989). That case is not factually similar to the contested matter sub judice, for several reasons. It involved the post-petition appointment of a property manager for an apartment complex, a property manager which had been managing the complex pre-petition. The property manager had not been receiving a management fee. Further, the manager was an insider of the debtor and appointment was being sought by the debtor in possession, not by a Code §1104 Trustee. The court in that case concluded that as further indicia of the non-applicability of Code §327 the debtor's apartment complex required a property manager whether or not the debtor was in Chapter 11. Finally, the bankruptcy court, while concluding that a Code §327 appointment was unnecessary, nevertheless required the property manager to file fee applications pursuant to Code §503 and give notice thereof to creditors and the United States Trustee. The

² While the Court has acknowledged the Trustee's contention that Wade and Hebert are not "creditors" within the meaning of Code §327(c), the Court concludes that they are at least parties in interest and will consider their objections to the appointment of AHMA.

role of the manager in Century Inv. Fund was much more akin to that of Wade and Hebert who managed the Debtor without seeking Court approval prior to their removal by the Trustee. Accordingly, this Court rejects any suggestion that AHMA or any hotel management firm for that matter, is not a professional within the meaning of Code §327 under the factual scenario presented by this case.

Wade and Hebert contend that AHMA has a conflict of interest here by virtue of its pre- and post-petition relationship with the FDIC, Debtor's largest secured creditor, as well as its management of what is alleged to be a competing resort hotel only forty miles from Alexandria Bay, New York.

Code §327(c) clearly articulates that it is an actual, not a potential or hypothetical conflict of interest which prohibits a professional's appointment. As noted by a respected commentator, "The absolute proscription against concurrent representation of a trustee and creditor in connection with the case was eliminated by the 1984 amendments. (Citations omitted) However, the prohibition against employment of professionals when an actual conflict exists remains intact. (citations omitted)... In light of the 1984 revision to §327(c) something more than the mere fact of dual representation must be demonstrated if there is to be disapproval of engagement by the Trustee." See Collier on Bankruptcy, 15th ed. ¶3.27.03 [4], pp. 327-73 to 327-76. See also In re Interwest Business Equipment Inc., 23 F.3d 311, 316 (10th Cir. 1994). It is obvious here that AHMA, due to its continuing affiliations with the FDIC, has the potential for a conflict of interest even though it would appear that both the Debtor and the

FDIC are desirous of seeing Debtor's hotel facility run efficiently, at least for the short term.

One must also consider the significant autonomy given to an §1104 Trustee to operate a Chapter 11 Debtor's business pursuant to Code §§1106 and 1108. See In re Curlew Valley Associates, 14 B.R. 506 (Bankr. D.Utah 1981); In re Lowry Graphics, Inc., 86 B.R. 74 (Bankr. S.D.Tex. 1988). This Court senses that Wade and Hebert strenuously oppose their loss of operational control over Debtor's hotel facility and have seized upon the potential conflict of interest of AHMA in an effort to create a smoke screen over the real basis for their opposition to the Trustee's motion.

From the testimony presented at the evidentiary hearing, the Court cannot reach the conclusion that Debtor's hotel facility in Alexandria Bay and the Holiday Inn in Ogdensburg are competing for the same segment of the hotel market. The Court is of the opinion, as testified to by John Connelly, AMHA's President, that the Holiday Inn is a "transient" hotel facility while Debtor's hotel is a "resort" facility, in spite of the relative close proximity of each hotel to the other. While not discounting the opinions of Daniel O'Brien, the expert proffered by Wade and Hebert, the Court believes that those opinions result from a very general tourism overview of the so-called "Thousand Islands" region of New York State, rather than an in depth operational analysis of each hotel facility and the market each hotel seeks to attract.

Having considered all of the evidence before it, the Court does not conclude that the appointment of AHMA on a permanent basis will result in an actual conflict of interest despite its

ongoing relationship with the FDIC.

One final issue raised by Wade and Hebert focuses on AHMA's alleged failure to initially disclose its potential conflict of interest due to its affiliation with the FDIC and its operation of the Ogdensburg Holiday Inn. They rely upon the recent decision of the First Circuit Court of Appeals in Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994) which observed, "Absent the spontaneous timely and complete disclosure required by §327(a) and Fed.R.Bankr.P. 2014(a), Court-appointed counsel proceed at their own risk". Id. at 59.

While the Court acknowledges the need for full disclosure prior to appointment of a professional, the Court concludes that AHMA made the requisite disclosure herein. In support of this Court's Order of May 26, 1995, AHMA submitted the Affidavit of John R. Connelly, which discloses at ¶¶ 4, 6 and 11, its affiliation with the FDIC and further discloses in an "Executive Summary", attached to that affidavit, the fact that it currently manages the Holiday Inn in Ogdensburg, New York, on behalf of the FDIC.

Based upon all of the foregoing, the Court concludes that it is in the best interest of all the creditors of this Chapter 11 case to grant the Trustee's Application filed June 12, 1995, to employ a management firm to manage and operate Debtor's hotel facility in Alexandria Bay, New York, and to designate AHMA as that manager in accordance with terms and conditions set forth in the Trustee's Application, dated June 9, 1995.

The Court will further require that the Trustee file with the Court, at intervals of not longer than ninety (90) days,

commencing with the date of this Order, an application seeking final approval of any and all compensation paid to AHMA during the preceding ninety (90) day period, said application to be supported by a summary prepared by AHMA which shall comply generally with Rule 216.1(a)(3) and (4) of the Local Rules of this Court.

IT IS SO ORDERED.

Dated at Utica, New York

this day of

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge